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PAPUA NEW GUINEA

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PAPUA NEW GUINEA ECONOMIC BRIEF

ISSUE 1. 2023

GLOBAL OVERVIEW

Global economic developments in 2023 have centred on debt sustainability, global economic recovery and falling inflation rates.

- The Global Sovereign Debt Roundtable discussed debt sustainability and restructuring during the IMF-World Bank Spring Meetings in 2023. The discussion focused on speeding up and improving debt restructuring processes under the G20 Common Framework.
- The global economy is recovering from the pandemic and Russia's invasion of Ukraine. Also, China's economic reopening reduces war-related energy, food, and supply chain disruptions. As a result, the IMF April 2023 World Economic Outlook anticipates GDP to bottom out at 2.8 % in 2023 before rising to 3 % in 2024.
- Global inflation is expected to drop from 8.7 % in 2022 to 7 % in 2023 and 4.9 % in 2024 since most central banks are tightening monetary policy to return inflation to the targeted rate.
- Production gaps, increased energy and fertilizer prices, and trade disruptions increased market volatility in agricultural commodities. However, increasing oil field investments and supplies will lower energy prices in 2023. In addition, prices for other commodities, such as metals, are subjected to diversifying supply, lowering prices.

Table 1: Selected Nominal Commodity Prices (US)

Commodity	2020	2021	2022	2023 (March)
Crude Oil, average ($/bbl)	41.26	69.07	97.10	76.47
Liquefied natural gas, Japan ($/mmbtu)	8.31	10.76	18.43	18.00
Cocoa ($/kg)	2.37	2.43	2.39	2.75
Palm oil($/mt)	751.77	1,130.58	1,275.99	972.06
Copper ($/mt)	6,173.77	9,317.05	8,822.37	8,856.3
Gold($/troy oz)	1,770.25	1,799.63	1,800.60	1,912.73
Nickel ($/mt)	13,787.26	18,464.97	25,833.73	23,288.61

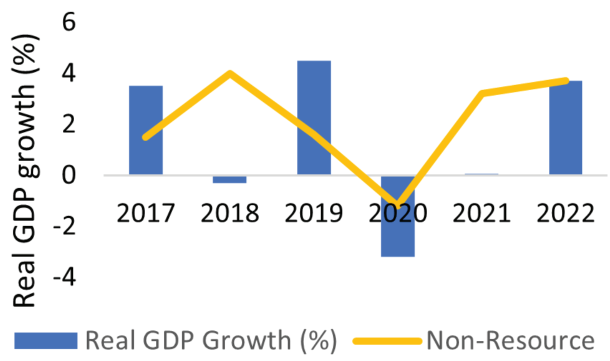
Source: World Bank

KEY DEVELOPMENTS IN 2023

Papua New Guinea witnessed a robust recovery in economic activity throughout 2022, outperforming the global economic outturn. According to estimates by the central bank, PNG's real gross domestic product (GDP) grew by 3.7% compared with 0.1% in 2021. This growth was propelled by heightened production and sales in both the mineral and non-mineral sectors, buoyed by the easing of COVID-19 restrictions and the upswing in international commodity prices. Additionally, the government's expansionary fiscal policy, coupled with strong business activity leading to increased sales by the private sector, played a pivotal role in driving economic growth. Furthermore, the employment level experienced a notable upturn, supported by a 6.9% expansion in private sector credit, fostering the recovery of overall economic activity.

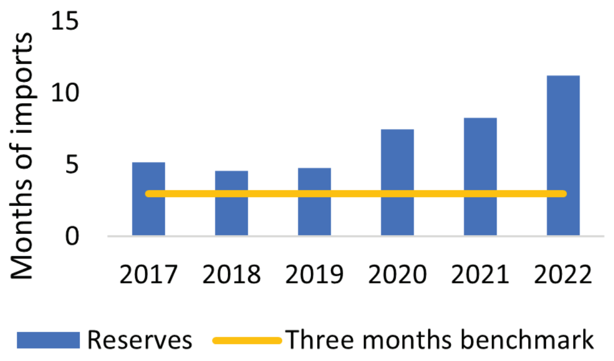
Headline inflation increased in 2022 relative to 2021. At the end of September 2022, headline inflation was recorded at 6.3%, comparing unfavourably to the 4.3% recorded for the same period in 2021. This uptick in inflation was due to increased prices of imported products such as alcoholic beverages, tobacco and betelnut, household equipment, transport, food, and non-alcoholic beverages. In addition, increased business costs, transport costs, and the cost of domestic consumption goods such as fruits and vegetables have reduced households' purchasing power and likely impacted livelihoods.

Chart 1: Real Gross Domestic Product Growth



The Bank of Papua New Guinea anticipates a current account surplus of K28,921.4 million in 2023, primarily driven by mineral exports. At the end of 2022, gross foreign reserves stood at US$4,132.2 million, equivalent to 11.2 months of total import cover. However, gross international reserves in the first quarter of 2023 have declined due to debt repayments and foreign exchange interventions. After that, reserves are expected to improve, but this will be conditioned on events in the extractive sector, such as the reopening of the Porgera gold mine and the progress of the Papua LNG project construction.

Chart 2: Imputed foreign reserves

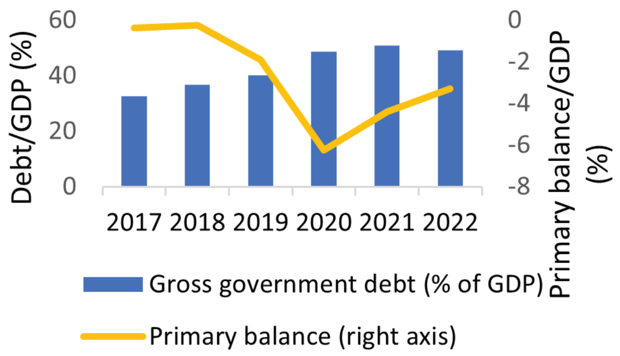


In the eleven months leading up to November 2022, the government's fiscal budget showed a deficit of K1,576.6 million, down from K3,398.1 million in the previous year. Further, K2,019.7 million was raised domestically to cover the deficit, offsetting a net external repayment of K236.3 million and resulting in a net increase of K206.8 million in government deposits. The lower deficit was due to windfall revenue of K3,804.9 million from LNG taxes, driven by higher international crude Oil and LNG prices. As a result, a Supplementary Budget in November 2022 allocated K1,588.5 million for new expenditures and around K1,000 million for domestic debt repayment.

The 2023 Budget plans K24,566.9 million in expenditure and expects revenue of K19,582 million, creating a deficit of K4,984.9 million (or 4.4% of GDP). The deficit will be financed by domestic sources (K1,465.7 million) and external financing (K3,519.2 million). Domestic financing includes new treasury bills (K525.7 million) and treasury bond issuances (K945 million). External financing consists of concessional sources (K515.8 million) and extraordinary sources (K3,018 million).

The total debt will increase to K59,142.6 million (52.3% of GDP). The proportion of total debt has significantly risen in the past five years, from 27.1% in 2017 to an estimated 49.2% by the end of 2022, according to the 2022 supplementary budget. The International Monetary Fund has approved a financing program of SDR 684.34 million (US$918 million) under its Extended Fund Facility, running from March 2023 to March 2026, to address PNG's financing needs.

Chart 3: Fiscal and debt performance



OUTLOOK

PNG's 2023 economic outlook is positive, with projected growth at 3.5% and inflation at 5.5%. The recovery of the extractive sector and strength in non-resource sectors drove a 3.7% growth in 2022. Higher government spending and growth in the manufacturing, wholesale, retail, hotels, and accommodation sectors will support further expansion. External risks include the Russia-Ukraine conflict and natural disasters. The reopening of the Porgera mine and other mineral projects will boost growth. Easing foreign inflation, improved energy and food supply chains, and a tight monetary policy contributed to the projected inflation rate. Vigilance is necessary to ensure sustained economic stability.

COUNTRY UPDATE

PNG seeks to enhance its foreign investment regime. PNG parliament amended the Associations Incorporation Bill and Investment Promotion Bill to improve the local business regulatory environment by promoting SMEs and FDI. The changes in the law included streamlining the foreign certification system and supporting SMEs by automatically rejecting applications for reserved activities which name local enterprises. The bills also stipulate the review of the reserve activities list every three years, introduce more reporting obligations on foreign investors, and provide powers to cancel certification where essential business laws are breached. In addition, the Registrar of Foreign Investment requires minimum investments from non-citizen investors seeking residency visas. The new laws are projected to improve government-business connections with non-profits and anti-money laundering compliance.

IMF Loan to Reform PNG. PNG is negotiating a Kina3.3bn (US$940m) 38-month IMF loan. However, loan disbursements will rely on benchmarks. The loan will boost government revenues and cut spending. The IMF financing will help PNG's economy and businesses. Policy changes under the next IMF program include exchange-rate liberalization, financial-sector deepening, and State-Owned Enterprises reform. The IMF financing does not increase PNG's debt risk. Presently, the weighted average interest rate for PNG's external loans is 2.8 %, and for domestic loans, 7.2 %, both higher than the 2.4 % IMF loan rate. In addition, the IMF loan has a 5.5-year grace period before the 10-year repayment. These generous terms will reduce repayment risk and provide optimism.

RISK PROFILE

The Economic Intelligence Unit, Moody's and Standards and Poor (S&P) credit rating agencies gave Papua New Guinea securities a speculative and high-risk rating with a stable outlook.

Table 2: PNG Risk Rating

Agency	Rating	Outlook	Date
Moody's	B2	Stable	Nov 22
S&P	B-	Stable	May 22
EIU	BB	Stable	Jan 23

Source: Moody's S&P, EIU

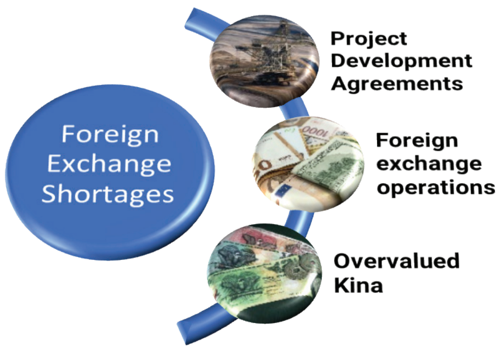
PNG's risk ratings were determined by the following:

- Global commodity prices and progress on major resource projects drive the buoyant economic outlook. In addition, the IMF ECF will provide additional budget support.
- Overvalued Kina is expected to move toward a market-determined exchange rate under the IMF package. Near-term exchange rate volatility
- The healthy capital adequacy ratios and rising profits in the banking sector. However, foreign exchange risk and exposure to heavily indebted state-owned enterprises.
- PNG has a sizeable current account surplus and significant potential growth in the commodity sector, but regulatory uncertainty and limited data impose constraints.

ISSUE FOCUS - PNG'S FOREIGN EXCHANGE PROBLEM

Papua New Guinea's foreign exchange problems are mainly due to an overvalued kina, which is pegged to the US dollar under a "crawling peg" policy. This policy has led to currency misalignment, foreign currency shortages and increased business costs. The government has been rationing foreign exchange to maintain the policy, exacerbating the situation.

In addition, a poor foreign exchange operations framework and weak capacity to forecast liquidity and manage foreign exchange operations have contributed to the foreign exchange challenges.



Project Development Agreements have contributed to the foreign exchange problem in Papua New Guinea by severely limiting the supply of foreign currency. These agreements often allow mineral companies, including the LNG project partners, to keep higher balance export receipts in offshore foreign currency accounts, making it unavailable to the country to meet import and debt service needs. This situation is further complicated because the non-mineral export sector does not generate sufficient foreign currency to compensate for the loss in available foreign currency induced by the PDAs.

Careful consideration and planning are required when negotiating project development agreements to ensure that the foreign exchange implications are adequately assessed and managed and to mitigate this issue. Other proposed solutions include moving towards a market-driven exchange rate.

However, it is important to note that transitioning to a market-driven exchange rate carries its risks and challenges. It could introduce volatility in the short term, potentially affecting import costs and inflation. Careful management and coordination with the IMF will be necessary to ensure a smooth transition and mitigate any adverse impacts. Finally, addressing the strength of the Bank of PNG's foreign exchange operations, economic regulations more broadly, and data quality will be crucial in the long term.

ECONOMIC POLICY RESEARCH

Innovative Financing Mechanisms and Solutions

According to the UN Economic Network Policy brief, innovative financing increases financial flow volume, efficiency, and effectiveness. Innovative finance continues to evolve in instrument and development goals. Traditional development funding cannot fund the SDGs globally, especially post-COVID-19. Thus, successful financing requires innovative methods. Governments must use all policy tools to optimize financial mobilization incentives. Governments, central banks, private finance, development players, and academia need new collaborations, roles, and institutional capabilities to succeed and maintain action.

SDG outcomes and development financing must be linked to optimizing the impact of development dollars.

DATA

The table below summarizes the key economic and social indicators underpinning this country brief. These data are taken from several sources and are the latest available. The 2022 data are estimates and are subject to revision.

	2017	2018	2019	2020	2021	2022 e
Real GDP growth (%)	3.5	-0.3	4.5	-3.2	0.07	4.5
Average inflation (%)	5.4	4.4	3.9	4.9	4.5	6.6
Unemployment (%)*	...	...	...	...	...	...
Primary balance (% of GDP)	-0.4	-0.2	-1.9	-6.2	-4.4	-3.3
Public sector debt (% of GDP)	32.5	36.7	40.2	48.7	52.1	49.2
Current account (% of GDP)	28.4	24.5	20.0	19.7	21.3 e	34.0 e

Source: IMF

** Assessing the unemployed rate in PNG is challenging because of the lack of data and the dominance of the informal sector. Note: e - estimate; ... - not available.*

This Economic Brief, a joint RCO and UNDP product, was prepared in good faith, exercising all due care and attention. The views expressed within are not necesarily the views of the UN and may not represent their policy.

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